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is doubtful whether Professor Patten can demonstrate such importance for natural monopolies under a free-trade *régime*. At any rate, the question between free trade and protection is, Which classes of natural monopolies get the benefit? Under protection it is manufacturing sites, dwelling sites, and limited raw material. Under free trade it would be agricultural land and transportation.

The controversy between protectionists and free traders is a matter of inferior significance. Whichever side wins, natural monopolies absorb the gain. Protectionists could materially strengthen their position — logically, if not politically — by devising methods for cheapening raw material. Iron, coal, and lumber are the bases of manufactures. If these were cheapened, Americans would not need protection, but could compete with the world in all markets. The following are tentative propositions for effecting this result:—

1. Free trade in raw material.
2. Special taxes on speculative holdings of mines, quarries, and timber lands.
3. Remove local taxes from capital and labor, and impose them on natural monopolies.

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“THE OVERPRODUCTION FALLACY.”

I.

In the April number of this *Journal* Mr. Uriel H. Crocker publishes what purports to be a rehabilitation of the “over-production” theory of industrial depression.* The paper deals specifically with Mill’s discussion of the question, and it is particularly Mill’s position that is claimed to have been refuted. It may, therefore, not seem ungracious to call to mind that, so long as we employ “demand” and “supply” in the meaning attached to those terms by Mill and commonly

* *Quarterly Journal of Economics*, April, 1892, p. 352.

accepted by those who are of his way of thinking, the proposition that aggregate demand equals aggregate supply is a truism. General overproduction, as defined by Mill,—“a supply of commodities in the aggregate, surpassing the demand,”—is a contradiction in terms. Aggregate supply *is* aggregate demand, neither more nor less.

The above-quoted definition of overproduction occurs in the pages cited from Mill by Mr. Crocker, and can therefore hardly have escaped his notice. But, as it seems not to have furnished any obstacle to the development of Mr. Crocker's argument, the simple calling attention to its significance will hardly be accepted as subverting the position taken by him. Mr. Crocker's position is not a simple, crude denial of Mill's proposition in this general form; but I believe it can be shown that the line of argument by which that position is supported is no less futile than the naïve overproduction theories that have been laid away by past economic discussion.

To Mr. Crocker's mind, the question as to a possible general overproduction takes form as follows:—

Is it possible that there should exist at any time an overproduction of one or more products, unless there is at the same time a corresponding underproduction of some other product or products? In other words, is it possible that one product should be selling for less than the ordinary profit over the cost of its reproduction, unless some other product is at the same time selling at more than the ordinary profit over the cost of its reproduction? (p. 356.)

His answer to this question is the following proposition:—

If at any time there is a production of a commodity not based upon and strictly proportioned to the adequate demand for it, but, with the knowledge of the producer, in excess of that demand, then there may at such time be an overproduction of that commodity and no corresponding underproduction of any other commodity. In other words, there may be in such case a general overproduction. (p. 356.)

The final conclusion is stated in this second proposition:—

A production of a commodity not based upon and strictly proportioned to the adequate demand for the product, but, with the knowledge of the producer, in excess of that demand, may arise, and has, in some cases, actually arisen, when machinery for the production of the commodity

has been created with a capacity of production in excess of the adequate demand for the product. (p. 358.)

The use of the term "adequate demand" is to be noted. "Adequate demand" is "the demand for a commodity at such a value as will afford the ordinary profit over the necessary cost of its reproduction." (p. 355.)

The concept of an "adequate demand" rests on the concept of an "ordinary profit." Now, we can intelligibly speak of adequate demand and ordinary profit without questioning either of those terms, so long as the discussion is concerned with the production of a particular commodity, or with a part, only, of the aggregate of industry. But a closer scrutiny will show that both terms break down when we come to deal with production in the aggregate.

The "ordinary profit," which an adequate demand must cover, is not a satisfactorily definite concept. It may be taken to mean the rate of profit commonly obtainable at the point of time with which the discussion deals, or it may mean the rate of profit that ought to be commonly obtainable at the time, or it may mean the rate of profit commonly obtainable during a more or less indefinite period preceding the time in question. In its colloquial use it has both the latter meanings, mingled in varying proportions. Which of these, or any other possible meaning, Mr. Crocker attaches to the term he does not say. The line of argument pursued by him requires the first of these definitions, or some definition which is like the first above given in being based on the rate of profit actually obtained at the time in question, and therefore, to a good extent, if not entirely, of the nature of an average of the profits actually obtained.

The ordinary rate of profit, in this sense, notoriously varies from time to time. The variations to which it is subject are due to particular variations in particular occupations. Being of the nature of an average, it varies with the fluctuations of the items that go to make up the average. If, in the manner supposed in Mr. Crocker's first proposition (p. 356), a given commodity comes to be produced at less than the ordinary profit previously obtained, the ordinary profit obtainable thereby

suffers a reduction, and, compared with the new ordinary profit therewith established, other commodities are now produced at more than ordinary profit; that is to say, overproduction of one commodity involves, other circumstances remaining unchanged, an underproduction of all other commodities, in the sense attached to "overproduction" by Mr. Crocker. The case supposed by Mr. Crocker resolves itself into a variation in the ordinary rate of profit.

From the general point of view, it is clear that any variation in the rate of profit in any one or more branches of industry, or in the production of any particular commodity, produces a variation, in the same direction, in the ordinary profit obtainable at the time in question, and a consequent divergence of the rate of profit in other occupations, in the opposite direction, from the new "ordinary profit." If the rate of profit in occupation B were to fall, without any change in the absolute rate of profit in occupation A, the ordinary rate of profit obtainable in the aggregate of occupations would fall; and consequently the rate of profit in occupation A would thereby rise, relatively to the altered general rate. The demand which previously was an "adequate demand," and no more, for the product of occupation A, would now have become an over-demand, not, conceivably, because of any change affecting the demand for that product directly, but simply in consequence of a change in the "ordinary profit" with which the rate of profit in occupation A is to be compared. That is to say, there would be an underproduction in occupation A in consequence of there being an overproduction in occupation B. It is accordingly necessary to say that any over-supply of one commodity implies, or rather involves, an under-supply, in the strict economic sense, of some or all other commodities. The first of Mr. Crocker's propositions therefore breaks down.

It is to be remarked that the typical case cited by Mr. Crocker (p. 358) of a production "not based upon . . . the adequate demand" also breaks down when it comes to the concrete application in the second of the two propositions. And the like would probably be true of any conceivable case. It is a case of an excess of production of a particular commodity, due to the creation of more fixed capital of a given kind than

the adequate demand for the product would warrant, and resolves itself into a case of misdirected or "ill-sorted" production, such as Mill has specially provided for in his discussion. It is a case of *relative* overproduction of a special kind of fixed capital, and a consequent depreciation of that fixed capital, either permanent or temporary. The reason for the continued production of goods to be sold at what the producer conceives to be less than a fair return is, professedly, the fact that an undue proportion of the aggregate capital has been fixed for the production of the particular commodity in question.

II.

While the doctrine of a general over-supply of goods — in the sense in which it has been criticised in economic theory — is palpably absurd, it must be admitted that the cry of "overproduction" that goes up at every season of industrial depression has a very cogent though perhaps not a very articulate meaning to the men who raise the cry. What is the nature of the fact that is symbolized by the colloquial use of "overproduction," and how it is related to "depression" and "liquidation," has never been satisfactorily made out. But no doubt it stands for an economic fact that merits the attention of any one who is curious to understand the phenomena of hard times and commercial crises.

The passages which Mr. Crocker quotes from D. A. Wells's *Recent Economic Changes* — and, more distinctly, certain other passages of that book — indicate the difficulty rather than solve it. It should be said, by the way, that Mr. Wells claims no originality with respect to the theory, or rather statement, which he puts forth, though he gives it a conciseness which it hardly had before.

General "overproduction," in Mr. Wells's use, means a general production in excess of the "demand at remunerative prices." And a remunerative price may be defined, for the present purpose, as a price that will afford the customary profit on the capital invested. If general prices become "unremunerative," the meaning of that fact, as expressed in terms

of this definition, is that the general run of profits has fallen below what is accepted as the customary rate of profits, or below the "ordinary profit," in the sense of what the business community accepts as the proper or adequate rate of profits for the time being.

"Overproduction," in the colloquial use of the word, as appealed to in explanation of depression in trade, is used to describe a situation where goods have been produced in excess of the demand at such prices as will afford the customary profit on the capital employed in their production. The average profit obtainable at the time on the capital invested falls short of the standard accepted as the proper, customary profit. This need not mean that the rate of discount at the time falls short of what is conceived to be the proper, customary rate. The trouble lies not primarily with the rate of profit on new investments, as indicated by the rate of interest on money seeking investment, but with the rate of profit on property already invested and capitalized in the past. The point of complaint is as to the earning capacity of investments already made. There may be much that is unsatisfactory with respect to the making of new investments; but that class of difficulties is evidently an effect, never a cause, of the trouble that exists with respect to the earning capacity of capital already invested and "capitalized" in the past.

The average rate of profit from past investments, indicated by the ratio of their earning capacity to their accepted capitalization, falls short of the accepted customary profit, indicated by the customary rate of interest on money seeking investment. The precise difficulty is that a divergence has taken place between the accepted nominal value of property, based on its past capitalization, and its actual present value, indicated by its present earning capacity or the present cost of replacing it. The actual present value of the property, as capitalized on the basis of its present earning capacity or on the cost of replacing it, falls short of its nominal, accepted value; and, as profits continue to be computed on the basis of this accepted nominal value, the rate of profit actually obtainable falls short of what is accepted as the customary and proper rate. The profit, computed on this basis, may even entirely disappear.

The "remunerative price," then, on which Mr. Wells bases his conception of "overproduction," turns out to be such a price as will afford the customary rate of profit to capital, as computed on the basis of its nominal value, or, in other words, on the basis of its accepted capitalization. Now, whenever the course of industrial development compels a readjustment of the basis of capitalization (as happens whenever the cost of production has been appreciably lowered), the customary basis on which the remunerative price has been computed becomes obsolete. The price, therefore, also becomes obsolete; and a reluctant acceptance of a new order of things follows, in which the capitalization and nominal value of property are readjusted on a revised scale of prices, which, in the new epoch, fixes the "remunerative price" that now affords the customary rate of profit on the revised capitalization.

The immediate economic fact for which "overproduction" stands is, therefore, a divergence between the nominal, accepted valuation and the actual present value of property engaged in production, in consequence of which the nominal earnings of capital (and in some cases the real earnings as measured in means of livelihood) are diminished. The characteristic fact in a case of general "overproduction" is that the basis on which "remunerative prices" and customary profit are computed has become obsolete.

This divergence may be due to several different causes, but usually and mainly to two general ones,—a speculative movement, and an increased efficiency of industry.* The action of the former of these needs no discussion here. A speculative movement may have pushed prices up unwarrantably. A fall of general prices, due to improved processes of production, may have depressed the actual present money value of property engaged in production below its nominal value. For the present purpose the immediate result is in either case much the same: the nominal, accepted valuation of the capital, on which its returns are computed, exceeds its

*The progressive accumulation of capital, by directly lowering the rate of profits, acts in the same direction as the two causes here mentioned; and some would perhaps rank it abreast with these two as an efficient agency in producing the situation for which an explanation is sought.

actual value as indicated by its present earning capacity. The property, perhaps the general aggregate property of the community, has come to be rated at a capitalized value above the cost at which it, or its equivalent for purposes of production, could now be replaced.

The hard times of the past decade is an example going to show how this result may be reached by a lowering of the cost of production; or, as some would perhaps prefer to express it, by an increase of the efficiency of industry.

If the analysis were carried a step further, it would appear that the divergence between the accepted valuation and the true present value of property, here ascribed to a lowering of the cost of production, is not due to the lowering of cost of production generally, simply as such, so much as to a lowering of the cost of production of some or all staple commodities as compared with the cost of production of the precious metals. The whole matter is very largely a matter of price,—of “values” in the commercial sense.

Such a divergence between the accepted valuation and the actual value of capital may seem an inadequate basis for an economic fact of such magnitude as a period of industrial depression. And yet an industrial depression means, mainly, a readjustment of values. It is primarily, to a very great extent, a psychological fact. Secondarily, it is largely a matter of the shifting of ownership rather than a destruction of wealth or a serious reduction of the aggregate productiveness of industry as measured in goods.

The act of readjusting one's conception of one's own belongings to the scale of a reduced number of dollars, even though the dollar is worth enough more to make up for the nominal depreciation, is in itself a sufficiently painful one, and is submitted to only reluctantly and tardily. But this subjective element, this lesion of the feelings of the property owner, is by no means all that is involved in a decrease of the nominal earning capacity of capital. Whenever the nominal owner of the means of production is not also the real owner, as happens in the case of borrowed capital, he becomes answerable to the real owner — the lender — for any amount by which the actual present value of the property may fall short of the ac-

cepted valuation. A decline in the market value of property represented by the debt, therefore, means a real loss to the debtor, although, so far as it is due to increased efficiency of industry, it may be only a nominal loss to the man who has to do with his own capital only, and may be, and generally is, a source of distinct though unrecognized gain to the lender. The borrower assumes the risk of depreciation of the property represented by the debt.

In a case such as has been witnessed in this country during the past ten or twelve years, when there has been a pretty general decline in the cost of production of staple commodities — as compared with the standard of value — and a consequent decline in the nominal earning capacity of property engaged in production, of perhaps 30 per cent., this factor is of the very gravest consequence. Especially is this true in the case of a community where so great a proportion of capital is represented by interest-bearing securities.

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TAXATION IN JAPAN.

During the entire feudal period of Japan down to the time of the Restoration (1868) the taxes of the people were paid in kind, and mainly in the form of rice. A sharp distinction was drawn between wet, or rice, land (*ta*) and dry land (*hata*), the former being far more valuable and yielding the bulk of the revenue. The taxes were, in most cases, paid to the government of the feudal lords, whose power was generally in proportion to their revenues, which were regularly reckoned as so many *koku* (five bushels) of rice. The theory then vaguely held was that the land belonged to the lord of the province; and the taxes were accordingly a form of rent paid to the *daimyo*, or landlord. The proportion of the rice crops paid in the shape of rent or taxes varied with the customs of each province or with the humors of the feudal lord;